The Annual Audit Letter for Shropshire Council

Year ended 31 March 2019

August 2019

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Shropshire Council (the Council) and its subsidiaries (the group) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council, the Group and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 23 July 2019.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council and group's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the group's financial statements to be £11,700,000, which is approximately 2% of the group's gross revenue expenditure. We determined materiality for the audit of the Council's financial statements to be £11,390,000, which is also 2% of the Council's gross revenue expenditure. We determined materiality for the audit of the pension fund accounts administered by the Council to be £18,650,000, which is 1% of the pension fund's net assets.
Financial Statements opinion	We gave an unqualified opinion on the group's financial statements on 1 August 2019. We also gave an unqualified opinion on the Shropshire County Pension Fund financial statements on 1 August 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 1 August 2019.

Executive Summary

Our work (continued)

Certification of Grants	We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions, certify the Teachers Pension Authority claim and the Housing Capital Receipts Grant. Our work on these claims is not yet complete and will be finalised by 30 November 2019. We will report the results of this work to the Audit Committee separately.
Certificate	We certified that we have completed the audit of the financial statements of Shropshire Council in accordance with the requirements of the Code of Audit Practice on 13 August 2019.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
August 2019

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the group's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the group financial statements to be £11,700,000, which is 2% of the group's gross revenue expenditure. We determined materiality for the audit of the Council's financial statements to be £11,350,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the group and Council's financial statements are most interested in where the group and Council has spent its revenue in the year.

We also set a lower level of specific materiality for and senior officer remuneration at £100,000 – as this is a sensitive item over which stakeholders will expect the Council to take particular care.

We set a lower threshold of £600,000, above which we reported errors to the Audit Committee in our Audit Findings Report.

Pension Fund Materiality

For the audit of the Shropshire County Pension Fund accounts, we determined materiality to be £18,650,000, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a threshold of £933,000 above which we reported errors to the Pension Fund's Pensions Committee.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report, annual governance statement and Annual Report published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the group's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
The revenue cycle includes fraudulent transactions Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Shropshire Council, mean that all forms of fraud are seen as unacceptable	We do not consider this to be a significant risk for Shropshire Council.
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. . We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	We have: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determine the criteria for selecting high risk unusual journals • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	We have not noted any issues in this area which we wish to draw your attention to.

Audit of the Financial Statements

Significant Audit Risks - continued

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of the pension fund net liability The Council's pension fund net liability represents a significant estimate in the financial statements and group accounts. The pension fund net liability is considered a significant estimate due to the value involved (£420 million in the Council's balance sheet as at 31 March 2018) and the sensitivity of the estimate to changes in key assumptions. We have therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.	We have: • updated our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluate the design of the associated controls • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work • assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation • assessed the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report • obtained assurances from the auditor of Shropshire County Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.	At the time the accounts were prepared there was significant uncertainty about whether the Government would have leave to appeal to the Supreme Court following the Court of Appeal's decision in the McCloud case concerning age discrimination in pension schemes. There were significant developments with this national issues during the course of our audit. In late June the Government was refused leave to appeal to the Supreme, which meant that the impact on local authorities pension liabilities became more certain. The Council commissioned an updated actuarial assessment to consider the impact of the McCloud court ruling on pensions liabilities. As a result the net pension liability increased by £11.8 million. This had no impact on the Council's useable reserves. We confirmed that the Council has processed the revised figures through their financial statements. We have concluded that there is a low risk of material estimation uncertainty within the pension fund net liability disclosed in the financial statements.

Audit of the Financial Statements

Significant Audit Risks - continued

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of land and buildings The Council revalues its land and buildings on a five-yearly basis. To ensure the carrying value in the Council and group financial statements is not materially different from the current value at the financial statements date, the Council requests a desktop valuation from its valuation expert. This valuation represents a significant estimate by management in the financial statements due to the value involved (£1.1 billion) and the sensitivity of this estimate to changes in key assumptions. We have therefore identified valuation of land and buildings as a significant risk, which was one of the most significant assessed risks of material misstatement.	We have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work • evaluated the competence, capabilities and objectivity of the valuation expert • discussed with the valuer the basis on which the valuation was carried out to ensure that the requirements of the Code are met • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding • tested revaluations made during the year to see if they had been input correctly into the Council's asset register	We have confirmed that the Council has used appropriately qualified Valuers and the valuations have been made on an appropriate basis in line with the Code. We found the assumptions used to be reasonable and have confirmed that the Council has processed the figures through their financial statements. We provided particular challenge around the varying value of assets not revalued as at 31 March 2019. We obtained sufficient evidence to confirm that there is a low risk of material estimation uncertainty within the overall valuation of land and buildings.

Audit of the Financial Statements

Significant Audit Risks - continued

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Pension Fund – valuation of level 3 investments Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end. We identified the valuation of level 3 investments as a risk requiring special audit consideration.	We have: • gained an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls • reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments • considered the competence, expertise and objectivity of any management experts used • for a sample of investments we tested valuations by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date.	Our work did not find any significant issues in the valuation of level 3 investments.

Audit of the Financial Statements

Significant findings from the Group audit

	Summary of issue	Audit Comments
Jersey Property Unit Trust (JPUT)	The Jersey Property Unit Trusts holds the three Shopping Centres in the centre of Shrewsbury. The Council owns a majority share of the units in a Jersey Property Unit Trust. The minority share is held by wholly owned subsidiary of the Council. The asset is held on the Balance Sheet as the Council and its subsidiary are the beneficial owners of the property. The Council revalued the three shopping centres as at 31 March 2019. This indicated a fall in value of £11.7 million resulting in an impairment being shown in both the Council's and the group financial statements.	We have: • undertaken an assessment of the value as management's experts • reviewed the completeness and accuracy of the underlying information used to determine the estimate • reviewed the reasonableness of the assumptions made by the valuer • reviewed the reasonableness of the decrease in estimate • reviewed the adequacy of disclosure of estimate in the financial statements We concluded that the reduction in value is reasonable.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the group's financial statements on 1 August 2019.

Preparation of the financial statements

The group presented us with draft financial statements in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

After the production of the financial statements, the Government was refused leave to appeal, which meant that the impact on local authorities pension liabilities from the McCloud case required revised figures to be obtained from the actuary. We worked closely with the Council to understand these revised figures and undertook additional procedures due to the significant changes proposed. We also undertook more detailed work around the asset valuations due to their size and the level of estimation uncertainty. Both of these risks incurred additional fees.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the group's Audit Committee on 23 July 2019.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in or alongside the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Pension fund accounts

We gave an unqualified opinion on the pension fund accounts of Shropshire County Pension Fund on 1 August 2019. We also reported the key issues from our audit of the pension fund accounts to the Pension Fund's Pension Committee on 24 July 2019.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which did not identify any issues for the group auditor to consider on 13 August 2019.

Other statutory powers

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have not exercised any of our additional statutory powers or duties.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Shropshire Council in accordance with the requirements of the Code of Audit Practice on 13 August 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

- *In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work. We identified one significant risk in relation to financial resilience in the medium to long term.

As part of our Audit Findings report agreed with the Council in July 2019, we identified agreed recommendations to address our findings. In particular:

- The Council's current financial position is a result of the decision making and speed of response to austerity by both members and senior officers over the past seven years. Cabinet has not made the scale of decisions to reduce and cut services required to deliver the savings required. Instead focusing on a series of strategies which have been 'refreshed' each year and provided several changes in direction. Whilst previous financial savings have delivered service redesign and avoided a top slicing approach to budget reductions, the Council has not yet delivered the recurrent savings required to deliver a financially sustainable position in the medium term. The current trajectory shows an increasing level of financial pressure that needs to be responded to.
- There was slippage against the delivery of savings plans in Commercial Services but there are governance processes in place to ensure that savings identified are robust.
- The Council is continuing to develop its commercial strategy which is not yet delivering income in line with the projections within the medium-term financial strategy. Tackling the development of robust, deliverable savings, as well as driving further income generation remains a top priority for the Council. Officers continue to present savings opportunities which require service delivery to be cut. These are generally only actioned in part meaning that other savings need to be identified and the impact of cuts is felt by an increased number of the Council's services. With the most significant cost pressures being within statutory mandatory services, the Council is limited as to where savings can be made.

Recommendation – *The Council needs to monitor decisions from the Government about its future funding and respond accordingly. As well as responding to any Government decisions it also needs to ensure that it makes appropriate decisions about Council Tax increases and ensures that income generation schemes and savings plans are delivered in full.*

Overall Value for Money conclusion

Based on the work we performed to address the significant risks, we concluded that the Council had proper arrangements in all significant respects to ensure it delivered value for money in its use of resources.

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	Findings	Conclusions
We carried out an initial risk assessment in February 2019 and identified one significant risk in respect of specific areas of proper arrangements using the guidance contained in AGN03. We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work. AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness. We have focused our work on the significant risks that we identified in the Council's arrangements. Shropshire Council has had financial challenges for a number of years, but the scale of these and the financial gap has remained in the medium term, providing the Council with the ability to take measured action to maintain financial balance. Our audit plan identified one significant risk which related to financial resilience over the medium to long term.	The Council's revenue position for 2018/19 delivered a net underspend of £0.167 million. Within this position there were pressures in Adult Social Care, Children's Services and Commercial Services, with Children's Services delivering the greatest overspend at £4.6 million. These overspends were offset by savings elsewhere. As part of its 2018/19 budget, the Council set a savings target of £15.5 million. It delivered £12.5 million of these savings across a number of services. For 2019/20 the Council has set an expenditure budget of £593.1 million, identifying a financial gap of 24.590 million between planned expenditure and resources. This is being closed by grants of £22.1 million and use of earmarked reserves of £2.5 million. The Council's Financial Strategy included savings totalling £18.490 million for 2019/20. Internal highlight reports suggest that around 50% of the savings have been delivered by 31 May 2019. The financial gap for 2020/21 after grants of £3.1 million and use of reserves of £19.7 million is £12.4 million. This estimated gap assumes that over £20 million of government funding such as Rural Services Delivery Grant, Improved Better Care Funding and Social Care Grant will not continue beyond the current Multi-Year Settlement which ends in 2019/20. This coincides with the Government's stated proposals to implement a new 'Fair Funding' methodology from 1 April 2020, the implications of which are unknown. The funding gap, under the same assumptions, increases to £39.1 million in 2021/22, £46.8 million in 2022/23 and £57.2 million in 2023/24. Resources have been assumed to remain at current levels due to the continued uncertainty about the future local government funding arrangements. Expenditure is forecast to increase significantly, mainly as a result of pressures and demand growth within Adult Social Care and Children's Services. General Fund reserves as at 31 March 2019 were £87.3 million, of which £71.7 million were earmarked for specific purposes. The General Fund balance of £15.536 million is below the Council's risk-based target of £20.4 million.	The Council does not have reserves to address these forecast financial gaps and so it is critical that further saving plans are identified and delivered to ensure that reserves are maintained at a financially sustainable level. The current financial strategy projects that reserves will have been fully depleted by 2020/21. We remain concerned that the Council is using non-recurrent funding from reserves to balance both its 2019/20 and 2020/21 budgets and fund recurrent expenditure. We have concluded that the Council delivered its 2018/19 budget and has adequate plans in place to deliver its 2019/20 budget. There are sufficient reserves to cover any financial shortfalls in savings or any unexpected reductions in income or funding in the short term. The Council's current financial strategy identifies a potential funding gap of £12.43 million in 2020/21, resulting in significant risks to financial sustainability for 2020/21 and beyond which the Council has already highlighted in its financial strategy.

Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Reports issued

Report	Date issued
Audit Plan	25 February 2019
Audit Findings Report	23 July 2019
Annual Audit Letter	14 August 2019

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit	103,061	115,061	133,845
Total fees	**103,061**	**115,061**	**133,845**

Audit fee variation

As outlined in our audit plan, the 2018/19 scale fee published by PSAA of £103,061 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

Area	Reason	Fee proposed
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	£3,000
Pensions – IAS 19 and PPE Valuation	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 and PPE valuations needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 and PPE valuations this year.	£6,000
JPUT	Additional audit work relating to the valuation and disclosure of JPUT	£3,000
Total		**£12,000**

Fee variations have been discussed with the Chief Financial Officer but not agreed. They are also subject to PSAA approval.

Reports issued and fees continued

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Fees for non-audit services

Service	Fees £
Audit related services:	
• Certification of Housing Benefits Subsidy Claim	13,445
• Certification of Teachers Pension Authority claim	4,800
• Certification of Housing Capital Receipts Grant	3,000
Non-audit services:	
• CFO Insights licence	10,000

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the group. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the group's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the group's policy on the allotment of non-audit work to your auditor.

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